address these issues will result in an incomplete regulatory system and further exacerbate the deficiencies of the FCC's proposed system.

1. The FCC Needs to Ensure that Cable Operators Have Access to the COS Regulatory System.

While the FCC's NPRM is not explicit on this matter, CCTA believes that it is imperative and self-evident that cable companies should have access to the COS ratemaking method at any point in time. In its Order, the FCC should clearly set forth this rule. If the COS regulations are to act as a backstop, they must also provide for the ability to act as a backstop when the company's situation, in particular, its costs, change. Failure to allow future access to COS would render the benchmark system confiscatory. Moreover, announcing now that companies will have access to COS in the future will reduce regulatory uncertainty and may reduce in the short term the number of COS filings, as many companies would wait until the COS regulations are in place.

2. The FCC Needs to Assure Companies that Elect COS That They Can Later Have Access to the Benchmark System.

A company that files for a COS showing should be allowed to access the benchmark system at its discretion. There are many reasons for this. First, in the event that company was satisfied with the benchmark system in the future after justifying rates based on COS, both the company and regulators would realize the administrative and other benefit associated with the benchmark system. Second, for some companies, their final COS rates may not differ significantly from the benchmarks. Therefore, they would suffer no disadvantage by allowing a transition to the benchmark system. In addition, the fact that the benchmark system is the primary system of regulation favors allowing companies to return to this system.

Administrative simplicity and fairness argue that the FCC allow access to the benchmark system for any company. Failure to allow for this transition will result in a myriad of petitions for exceptions based on a variety of different rationales. At least some of these cases will have merit. The likely result will be a continuing complex set of rules governing transition from one type of regulation to another.[117] Rather than invite this evolution, the FCC should simply allow access to the benchmarks.

3. The FCC Should Establish Benchmark Rates as a Floor.

The FCC should reverse its prior holding in the May 3, 1993 Report and Order that election of COS opens a company to the possibility of rate setting below the benchmark. The FCC can accomplish this with a rule that the benchmark rates are a floor. At the present time, companies are unduly burdened because they

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[117] The possibilities for monitoring the classification of systems by type of regulation reminds one of the FERC prior to gas deregulation. Regulation of wellhead gas prices prior to deregulation was based on the type of gas. Disputes and court challenges regarding the classification of various gas supplies endlessly occupied the FERC and contributed to the abandonment of the regulatory system.

must make a regulatory election without sufficient information on the COS regulations. At a minimum, those operators choosing COS without the benefit of a full understanding of the rules should be allowed to return to the benchmarks at any time within one year.

4. The FCC Must Permit Operators to Choose COS or Benchmarks on Any or All Tiers.

The Commission did not directly address this issue in the NPRM. Again, administrative simplicity argues for allowing companies to elect COS for one tier and the benchmark system for another. The arguments are similar.

5. The FCC Must Propound Rules for Cost Allocations That Serve the Common Interest of the Cable Industry and Its Subscribers in Technological Expansion.

Cost allocation rules will be essential. It should be noted that accounting-based allocation rules may not be workable. The decision to expand systems and add unregulated services could be held hostage to inflexible allocation rules, as such rules might allocate a disproportionate cost to the new expansion and thus unduly burden the expansion. Placing a burden on expansion is not in the interest of consumers. The cost allocation rules should encourage such expansions by sharing the benefits of the expansion, and not by penalizing the systems for the addition of channels.

6. Advertising and Other Revenue Sources Should Be Excluded from the COS Calculation.

These sources should either be entirely excluded from the COS calculation. The inclusion of advertising revenues greatly reduces, if not eliminates, any incentive for a COS-regulated firm to expand its advertising revenues.

7. COS Rates Must Permit Companies to Submit Rate Applications Based on Their Particular Circumstances.

The FCC is striving to develop a streamlined system. The FCC proposes one ROR for all companies.[118] Similarly, the FCC is interested in one set of rules and would restrict local discretion in the application of the COS rules.[119] The FCC's fundamental philosophy is that all operators can fit to a relatively uniform COS regulatory system. However, CCTA's cost analyses[120] illustrate that there are large differences between franchises.

8. The Regulatory System Should Reflect the Higher Costs Present in the Higher Cost Regions of the Company.

To avoid unfairly and unduly burdening higher-cost operators in higher-cost regions of the country, such as California, the regulations should ensure that the methodology adopted fully

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[118] NPRM, ¶ 46.

[119] See May 1993 Report and Order, ¶ 270.

[120] See Section II.

reflects the cost differentials in different markets. The failure to reflect these cost differences will add to the problems with the entire regulatory program. This is already a problem with the benchmark system. The higher cost of doing business in California is illustrated below:[121]

COMPARISON OF COST FACTORS

	U.S. Average	California	% of U.S. Average
Worker's Compensation (annual cost/employee)	$501.80	$764.40	152%
Average hourly wage	$11.46	$12.19	106%
Corporate taxes	6.7%	9.4%	139%

A partial solution to this problem would be to revise the benchmark system to reflect these cost differences and provide for higher benchmark rates for operators in higher-cost areas. This type of revision would alleviate some of the difficulties with the FCC's approach.

9. The FCC Should Permit Local Discretion in the Application of the COS Rules.

Given the difficulties in applying a uniform COS methodology, the FCC should allow local jurisdictions latitude in the application of the COS standards. This latitude is

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[121] San Francisco Chronicle, June 14, 1993, page C-1.

consistent with the intent of the Act which grants jurisdiction for basic rates to the local jurisdictions. Local discretion will also promote ratemaking approaches that are responsive to local requirements and the specific situations of the cable companies. In any event, franchise authorities should not be permitted to impose stricter standards than the COS rules adopted by the FCC.

10. Small Cable Television Systems Should Be Given More Generous Benchmarks and a Special Section of FCC Advocates of Small Systems Should Be Created to Advocate Their COS Cases.

Small cable television systems have been an essential and integral part of the development of cable television in the United States. Most of the industry's owners started as small cable television operators serving areas of poor reception in rural communities. There would be no cable television industry but for the investments of small cable television owners in small cable television systems small systems are active in construction and expansion of systems, innovation and testing of new services and employment and training of people. Congress indicated in the Cable Act that the FCC is to maintain small business delivery of cable television.[122]

The expense for filing and prosecuting a COS case could easily run from $50,000 to $100,000, which would be $50 to $100 per customer for a system of 1,000 customers, two to four months

[122] Communications Act of 1934, Section 623(i).

total gross revenue.[123] This burden is unreasonable. Moreover, the passage of the Cable Act of 1992 has created grave regulatory risk: a small entrepreneur may become bankrupt either through an unfavorable FCC decision or the cost of trying to obtain a favorable one.

Moreover, large numbers of the public will be denied access to cable television if small systems are not given relief. Many low-density areas, especially new developments not adjacent to existing cable television systems, are first served by, and remain primarily served by, small cable television systems. The effect of COS rules will be to deny cable television service to those areas.

The most useful step for the FCC would be to allow greater flexibility from its benchmarks by small cable television systems. There is a choice here: preserve small cable television systems or impose harsh and burdensome COS rules. For small systems the expenses of a COS proceeding cannot be amortized across large numbers of subscribers. The areas served by small systems are less dense and more marginal than the MSOs, and no economies of scale are present. Therefore, the Commission should allow cable television systems with under 5,500 subscribers up to 20% flexibility vis-a-vis the benchmarks before a COS showing is

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[123] Estimate by Barakat & Chamberlin.

required.[124] In other words, small systems could exceed benchmark rates by up to 20% before a COS showing was needed.

In the absence of this relief and for systems that still need a COS proceeding, the FCC should create a small cable television advocacy group within the Commission whose job would be to handle the advocacy for small systems. Thus, small systems would not need to hire expensive experts and journey to Washington, D.C. Within some reasonable parameters these advocates should be authorized to grant relief and instructed, where greater relief is sought, to advocate the small system's case to the Commission. They should travel to the system to remove the burden that small system entrepreneurs and managers must bear to go to Washington, D.C.

Finally, the Commission must recognize that smaller systems face a higher cost of capital. For example, a major small system lender was most recently charging 21% interest for loans to small systems.[125] This rate contrasts with bonds issued by public

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[124] The figure of 5,500 subscribers is based on the assumption that the cost of regulatory compliance at the FCC should not exceed the average cost of local regulation, which for small systems is 3%. Thus, assuming $50,000 is the minimum expense for a COS case, and assuming $300 per subscriber per year average revenue, the 3% threshold is passed in a system of under $1,670,000 in annual revenue, equating to a system of 5,500 subscribers.

[125] See loans by Phoenix Capital. Documents will be provided to the Commission upon request.

companies in the 9%-11% range.[126] The FCC must set separate and much higher cost-of-capital rules for small systems.

11. Given That the Development of the FCC Rules Will Take Time, the FCC Should Provide Companies with Latitude in the COS Justification for Rates During a Transition Period.

It is important to recognize that the cable television industry is in transition from an unregulated rate environment to a regulated industry. Therefore, certain regulatory policies that the FCC adopts might only be needed for a transition period. For example, if the FCC allowed preregulatory acquisition premiums as part of the rate base, then over time the acquisition premiums would be depreciated and the regulatory scheme would naturally transition toward using rate bases without acquisition premiums. Also, the FCC could establish explicit transition rules, although this could be more difficult.[127]

IV. THE COMMISSION MUST TAKE INTO ACCOUNT THE NON-RATE INTEREST OF THE CONSUMERS IN TECHNOLOGICAL DEVELOPMENT.

In its NPRM the Commission stated:

> Congress also identified the policy goal of ensuring that cable operators continue, where economically justified, to expand their telecommunications infrastructure. The commission agrees that cable operators can, and should, contribute to the continued development of an advanced telecommunications infrastructure. Cable operators have

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[126] See, for example, Paul Kagan Associates, Inc., Cable TV Finance, July 31, 1993.

[127] The FCC has recognized the possibilities of transition rules. NPRM, ¶ 40.

> major communications capabilities in place and are rapidly making facilities and services improvements. They are also actively exploring ways to combine existing services with new telecommunications services that could increase competition in the provision of communications services to the public and bring new services to consumers. We also believe that, in the near future, cable operators may experience significant competition in delivery of video programming to consumers. We believe that, consistent with the Act, our requirements should not thwart operators' ability to respond to competitive forces by means of facility and service improvements. For these reasons, we further tentatively conclude that our regulatory requirements for cost-based rates should also be designed to assure that cable operators may fully respond to incentives to provide a modern communications infrastructure and to respond to competitive forces. We believe that such an approach directly serves Congress' intent to encourage "economically justified" expansion of the cable infrastructure."[128]

The cases require the Commission to take into account the nonrate interest of consumers in future technological development and system expansion by cable operators.[129] The expansion of the telecommunications infrastructure by the cable television industry is in the consumer interest. Expansion of communications capacity by the cable television industry increases not only the competitiveness of cable television companies, but also the international competitiveness of the United States. Such expansion also brings new services to consumers.

As direct broadcast by satellite (DBS), expanded MMDS, video dial tone, and other technologies become deployed, CCTA believes that the Commission is correct in its assumption that cable

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[128] NPRM, ¶ 9.

[129] See Farmers Union, 734 F.2d at 1502-03; Section I.B.1., supra.

operators will experience significant competition through new technologies in the near future. COS rules should not hamper the ability of cable television operators to expand their technological base so that they can compete in the new markets being developed for video transmission.

One of the reasons why cable television companies, pay few, if any, dividends is that the cable television industry continuously is continuously reinvesting in new plant. This continuous reinvestment is in response to the environment of rapid innovation that requires the deployment of new technologies to meet the needs of consumers for new video services.

COS rules must permit cable television operators to meet the nonrate interest of the consumers in technological development to satisfy the congressional intent under the Act.

V. THE FCC NEEDS TO CAREFULLY STUDY AND REASONABLY REVIEW THE ISSUES PRESENTED IN THESE COMMENTS PRIOR TO ADOPTING FINAL COS RULES.

The FCC needs to engage in a careful and reasoned examination into its entire COS regulatory methodology to provide for the differences between the cable industry and traditional utilities that will totally vitiate the workability of the proposed COS methodology. This examination must address all of the potentially competing goals and issues facing the industry. These issues include:

1. Constraints on Charging COS rates. Because some systems will not be able to charge COS rates, the FCC must provide an

opportunity for those companies to earn a return by providing those companies with optional COS methods that reduce the front-end load problem.

2. Acquisition Premiums and Intangible Assets. Implementing COS regulations that do not provide for an adequate recovery of acquisition premiums will result in an inadequate regulatory system in that numerous systems will, effectively, not be able to avail themselves of the "backstop" provided by COS.

3. Rate of Return. The FCC's approach is wholly inadequate as it does not reflect the realities of the industry. Application of the surrogate method would result in calculated returns that are inconsistent with the surrogates and do not provide the operators with an opportunity to earn a return commensurate with the risks assumed.

Each of these are major, complex issues. Other agencies have spent months, if not years, on these issues. The FCC needs to establish a long-term, reasoned approach to developing an overall COS regulatory system.

CONCLUSION

CCTA has demonstrated that the traditional COS rules proposed in the FCC's NPRM will not arrive at reasonable rates. To avoid results that violate the Fifth Amendment's prohibition against confiscatory rates, the FCC's rules must take into account the key issues of acquisition premiums, intangibles, and rate of return. In light of the economic structure of the industry and the expectations of investors, the FCC's rules must permit cable companies to have access to the capital markets for expansion of their technological base, both to comply with the constitutional requirements of Hope and to comply with the balance of investor and consumer interests as expressed in the 1992 Cable Act. No one, including consumers, the cable industry, the Commission, and franchise authorities, has an interest in rules that lead to unconstitutional rates. Therefore, the Commission must act now to study the economics of the cable industry and develop COS rules that will yield rates within the zone of reasonableness.

Respectfully submitted,

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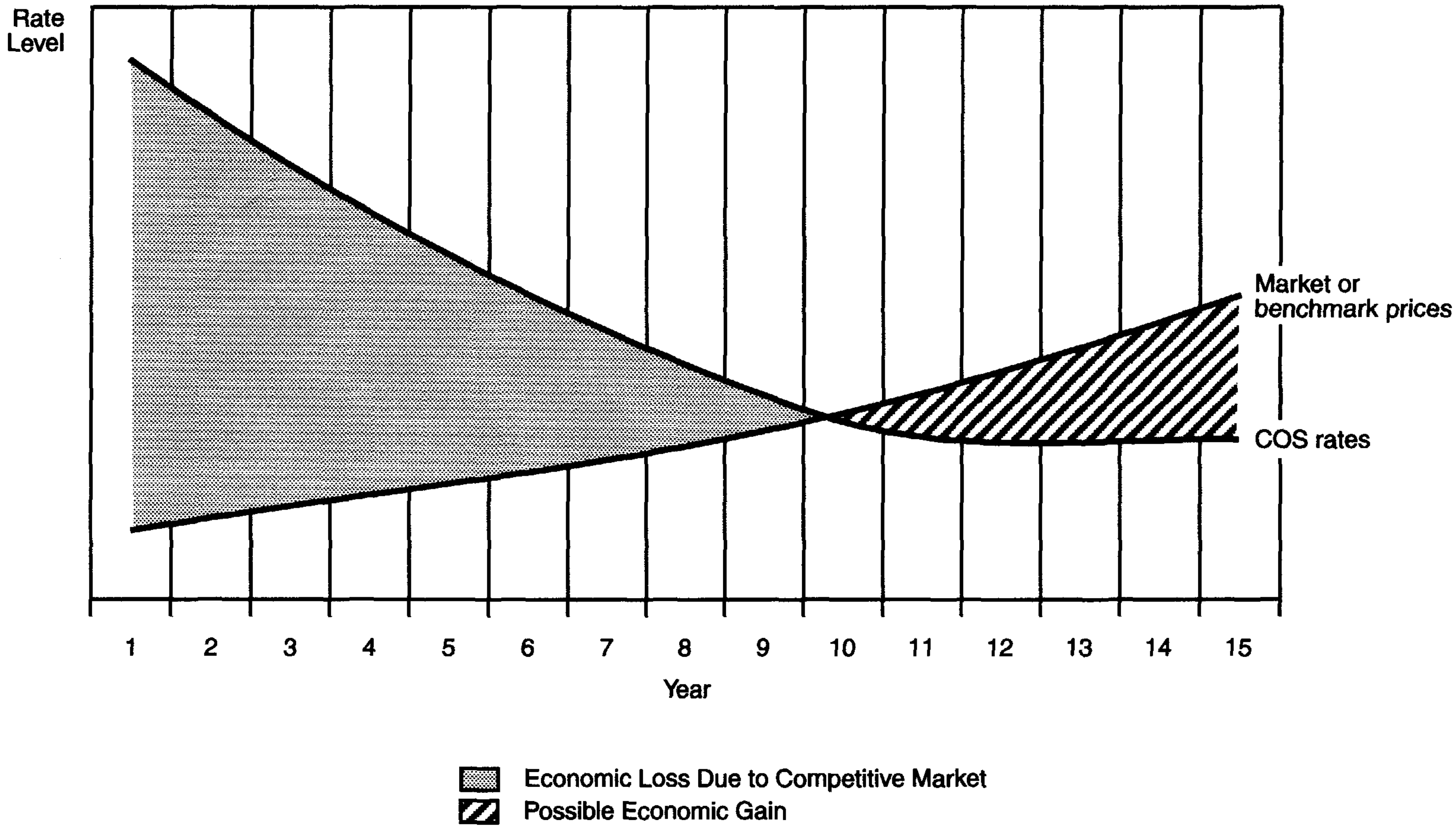
Table 1
Comparison of Market and COS Price Paths



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ATTACHMENT A

TABLE 2

VALUE OF CABLE SYSTEM AQUISITION PREMIUMS

A Study of 22 Public Cable Television System Operators

(as of 12/31/92)

Cable System Operator 1/	1 Total Company Revenue ($ Mil.)	2 Cable Revenue ($ Mil.)	3 Cable Revenue % of Total	4 Book Value- Net Tangible Assets 2/ ($ Mil.)	5 Book Value- Net Acquisition Premium 3/ ($ Mil.)	6 Est. Book Value - Net Cable Tangible Assets ($ Mil.)	7 Est. Book Value - Cable Acq. Premium ($ Mil.)	8 Est. Book Value - Total Cable Assets 4/ ($ Mil.)	9 Acq. Premium as % of Cable Assets ($ Mil.)
			(col.2/col.1)			(col.3*col.4)	(col.3*col.5)	(col.6+col.7)	(col.7/col.8)
Adelphia	$276.725	$276.715	100.00%	$371.357	$499.993	$371.344	$499.975	$871.319	57.38%
Cablevision Systems	$572.487	$572.487	100.00%	$529.366	$579.366	$529.366	$579.366	$1,108.732	52.25%
Century Communications	$312.317	$328.227	105.09%	$446.670	$247.115	$469.424	$259.703	$729.128	35.62%
Comcast	$900.345	$728.213	80.88%	$957.086	$0.000	$774.106	$0.000	$774.106	0.00%
Comcast/Philadelphia L.P.	$76.423	$76.423	100.00%	$50.999	$0.000	$50.999	$0.000	$50.999	0.00%
C-TEC	$256.564	$85.299	33.25%	$327.920	$137.418	$109.022	$45.687	$154.709	29.53%
E.W. Scripps	$1,263.405	$246.050	19.48%	$718.669	$612.024	$139.962	$119.193	$259.154	45.99%
Falcon Cable	$50.616	$50.616	100.00%	$68.696	$50.956	$68.696	$50.956	$119.652	42.59%
Galaxy Cable MLP	$18.034	$18.034	100.00%	$23.270	$2.076	$23.270	$2.076	$25.346	8.19%
Jones Intercable	$130.989	$130.989	100.00%	$166.397	$113.118	$166.397	$113.118	$279.515	40.47%
Jones Intercable L.P.	$38.338	$38.338	100.00%	$28.183	$23.626	$28.183	$23.626	$51.809	45.60%
Jones Spacelink	$158.693	$158.693	100.00%	$189.484	$146.725	$189.484	$146.725	$336.209	43.64%
Media General	$577.659	$117.400	20.32%	$539.758	$0.000	$109.697	$0.000	$109.697	0.00%
MERCOM	$11.986	$11.986	100.00%	$19.982	$3.320	$19.982	$3.320	$23.302	14.25%
Multimedia	$576.781	$156.645	27.16%	$218.510	$269.141	$59.344	$73.095	$132.439	55.19%
Scripps Howard	$389.819	$112.292	28.81%	$196.754	$280.139	$56.677	$80.697	$137.375	58.74%
TCA Cable	$138.839	$138.839	100.00%	$104.681	$179.916	$104.681	$179.916	$284.597	63.22%
Tele-Communications, Inc.	$3,574.000	$3,474.000	97.20%	$4,384.000	$6,399.000	$4,261.336	$6,219.957	$10,481.293	59.34%
Time Warner Inc.	$13,070.000	$2,091.000	16.00%	$3,266.000	$14,542.000	$522.510	$2,326.497	$2,849.007	81.66%
Times Mirror	$3,701.973	$438.641	11.85%	$1,756.840	$1,140.902	$208.165	$135.184	$343.349	39.37%
Viacom	$1,864.683	$411.087	22.05%	$457.065	$2,195.936	$100.764	$484.115	$584.879	82.77%
Washington Post	$1,450.867	$174.098	12.00%	$390.804	$325.420	$46.895	$39.049	$85.944	45.44%
Totals/Averages	$29,411.543	$9,836.072	33.44%	$15,212.491	$27,748.191	$8,410.305	$11,382.255	$19,792.560	57.51%

Source: Columns 1,2,4 and 5 - Kagan Cable TV Financial Data Book, June 1993

1/ These cable system operators accounted for approximatley 33.8 Million of the estimated 55.2 million cable subscribers at year end 1992. (as estimated by Paul Kagan Associates)

2/ Book value of property, plant and equipment net of accumulated depreciation

3/ Book value of intangible assets net of accumulated amortization

4/ Excluding working capital

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ATTACHMENT B